

立法會
Legislative Council

LC Paper No. CB(1)1942/13-14
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

**Minutes of meeting
held on Monday, 5 May 2014 at 9:00 am
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Starry LEE Wai-king, JP (Chairman)
Hon Christopher CHEUNG Wah-fung, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, GBS, JP
Hon WONG Kwok-hing, BBS, MH
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon CHAN Kin-por, BBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon SIN Chung-kai, SBS, JP

Members attending : Hon Emily LAU Wai-hing, JP
Hon TANG Ka-piu

Public officers attending : Agenda Item IV

Mr Norman CHAN, GBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Peter PANG, JP
Deputy Chief Executive (Development)
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive (Banking)
Hong Kong Monetary Authority

Mr Francis CHU, JP
Acting Deputy Chief Executive (Monetary)
Hong Kong Monetary Authority

Mr Darryl CHAN
Executive Director (Corporate Services)
Hong Kong Monetary Authority

Agenda Item V

Mr Eddie CHEUNG
Deputy Secretary for Financial Services and the
Treasury (Financial Services)²

Miss Emmy WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)³

Agenda Item VI

Mr Patrick HO, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services)³

Mr Arsene YIU
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)⁶

Miss Monita YU
Assistant Official Receiver (Case Management)
Official Receiver's Office

Agenda Item VII

Mr Maurice LOO
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)⁴

Attendance by invitation : Agenda item V

Mr Darren McSHANE
Chief Regulation and Policy Officer and
Executive Director
Mandatory Provident Fund Schemes Authority

Ms Gabriella YEE
Head (Policy Development and Research)
Mandatory Provident Fund Schemes Authority

Agenda Item VII

Mr John POON, JP
Chairman
Financial Reporting Council

Mr Mark DICKENS, JP
Chief Executive Officer
Financial Reporting Council

Ms Wincey LAM
Deputy Chief Executive Officer
Financial Reporting Council

Clerk in attendance: Ms Connie SZETO
Chief Council Secretary (1)⁴

Staff in attendance : Ms Angel SHEK
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Agenda Item V to VI

Mr Timothy TSO
Assistant Legal Adviser 2

Action

I Confirmation of minutes of meetings and matters arising

(LC Paper No. CB(1)1310/13-14 — Minutes of the meeting on
6 January 2014)

The Chairman said that Mr CHAN Kin-por had proposed amendments to paragraph 9 of the draft minutes of meeting on 6 January 2014 in relation to "Declaration of interests" under agenda item IV "Briefing on the work of the Financial Services Development Council". The proposed amendments which were marked-up and tabled at the meeting, were as follows –

"Mr Kenneth LEUNG declared that some members of FSDC were his colleagues in the law firm he worked for. Mr CHAN Kin-por declared that some members of a company to which he was an adviser were members of FSDC's committees. The Chairman declared that some members of the company she worked for were members of FSDC's committees."

2. Mr Andrew LEUNG opined that the nature of the matter referred to by Mr CHAN Kin-por was more a "disclosure" than a "declaration" as it did not appear to involve personal interests. Taking into account Mr LEUNG's suggestion, members agreed to make the following amendment to paragraph 9 of the said minutes –

"Mr Kenneth LEUNG declared that some members of FSDC were his colleagues in the law firm he worked for. Mr CHAN Kin-por ~~declared~~ disclosed that some members of a company to which he was an adviser were members of FSDC's committees. The Chairman declared that some members of the company she worked for were members of

FSDC's committees."

3. Members agreed that, subject to the amendments in paragraphs 1 and 2 above, the minutes of the meeting held on 6 January 2014 were confirmed.

(Post-meeting note: After the meeting, the Chairman and Mr Kenneth LEUNG proposed further amendments to paragraph 9 of the minutes of the meeting on 6 January 2014, which were issued to members on 7 May 2014 vide LC Paper No. CB(1)1373/13-14. As no comments were received from members on the proposed amendments by the deadline on 9 May 2014, the minutes were taken as confirmed.)

II Information papers issued since the last meeting

(LC Paper No. CB(1)1244/13-14(01) — Letter dated 21 February 2014 from Hon TANG Ka-pui on issues relating to filing of Employer's Return (Chinese version only)

LC Paper No. CB(1)1244/13-14(02) — Administration's response dated 8 April 2014 to issues raised by Hon TANG Ka-pui on issues relating to filing of Employer's Return

LC Paper No. CB(1)1264/13-14(01) — Letter dated 11 April 2014 from Hon Christopher CHEUNG Wah-fung on establishment of mutual market access between the stock markets of Hong Kong and Shanghai (Chinese version only)

LC Paper No. CB(1)1275/13-14(01) — Hong Kong Monetary Authority Annual Report 2013

LC Paper No. CB(1)1318/13-14(01) — Administration's paper on first quarterly report of

2014 on Employees
Compensation Insurance
— Reinsurance Coverage
for Terrorism)

4. Members noted the information papers issued since the last regular meeting held on 7 April 2014.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)1309/13-14(01) — List of outstanding items for discussion

LC Paper No. CB(1)1309/13-14(02) — List of follow-up actions)

5. Members agreed to discuss the following items proposed by the Administration at the next regular meeting on 6 June 2014:

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation; and
- (b) Consultation conclusions of corporate insolvency law improvement exercise and proposals on the introduction of a statutory corporate rescue procedure.

Establishment of Shanghai-Hong Kong Stock Connect

6. Referring to his letter dated 11 April 2014 to the Chairman (LC Paper No. CB(1)1264/13-14(01)), Mr Christopher CHEUNG said that following Vice Premier LI Keqiang's announcement on 10 April 2014 on the establishment of the mutual market access between the Shanghai and Hong Kong stock markets, the Panel should discuss related issues as soon as possible. He suggested inviting the Secretary for Financial Services and the Treasury and representatives from the Hong Kong Exchanges and Clearing Limited ("HKEx") for the discussion. Members agreed to include the item on the agenda for the meeting on 6 June 2014. The Chairman said that members might take the opportunity to exchange views with HKEx on other matters of mutual interests relating to HKEx.

(Post-meeting note: The regular meeting in June 2014 was subsequently re-scheduled to 2:30 pm on 9 June 2014 to avoid

clashing with the anticipated continuation of the Council meeting of 4 June 2014. As advised by the Administration and with the concurrence of the Chairman, the item on "Consultation conclusions on corporate insolvency law improvement exercise and proposals on the introduction of a statutory corporate rescue procedure" was deferred to the regular meeting in July 2014.)

IV Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)1309/13-14(03) — Paper provided by the Hong Kong Monetary Authority)

Briefing by the Administration

7. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Development)/HKMA ("DCE(D)/HKMA"), the Deputy Chief Executive (Banking)/HKMA ("DCE(B)/HKMA") and the Acting Deputy Chief Executive (Monetary)/HKMA ("Atg DCE(M)/HKMA") updated members on the work of HKMA through a powerpoint presentation covering topics on assessment of risks to Hong Kong's financial stability, development of financial market, banking supervision and investment performance of the Exchange Fund ("EF").

(*Post-meeting note:* The notes of the powerpoint presentation (LC Paper No. CB(1)1375/13-14(01)) were issued to members vide Lotus Notes e-mail on 8 May 2014.)

Discussion

Development of offshore Renminbi business

8. Noting that the daily trading band of Renminbi ("RMB")/United States Dollar ("USD") exchange rate was widened from 1% to 2% in mid March 2014 and the subsequent fall of RMB/USD exchange rate from its peak level, Mr Andrew LEUNG sought HKMA's assessment of the impact on Hong Kong's offshore RMB business. CE/HKMA said that the widening of RMB's trading band would allow the currency to float more freely in response to the supply and demand situation, and the range of +/-2% was considered sufficient. This trend would have a positive impact on Hong Kong's offshore RMB business as two-way movement, including appreciation and

depreciation, of a currency's exchange rate based on market forces, would be conducive to the development of the currency market.

9. Mr Jeffrey LAM noted that RMB non-deliverable forwards ("NDFs") that captured on RMB's weakening trend had proliferated in the market. As such derivative products and other RMB structured deposits were not covered by the Deposit Protection Scheme ("DPS"), he expressed concern about the risks associated with such products and asked if HKMA would enhance public awareness of the risks involved and step up surveillance over banks in the sale of the products.

10. CE/HKMA said that NDFs and structured deposits linked to a currency had been offered in the Hong Kong market for some years and the investing public at large had gained knowledge and experience in such products. HKMA had been reminding banks on a regular basis that they should pay due regard to the needs of the customers and the suitability of the investment products to the customers when marketing investment products to them. DCE(B)/HKMA added that, to assist the public to distinguish between DPS protected and non-DPS protected financial products, DPS member banks were required to make negative disclosure to investors in accordance with the DPS Representation Rules if the products were not DPS-protected. Banks' compliance with the Representation Rules was monitored by compliance reviews and on-site examinations. So far, no major compliance issues/problems had been identified.

11. Mr Christopher CHEUNG noted that cross border trading under the Shanghai-Hong Kong Stock Connect ("S-HK SC") would be subject to quotas in RMB. He enquired about the impact, if any, on the development of Hong Kong as an offshore RMB business and the stability of the Hong Kong Dollar ("HKD") exchange rate. Mr CHEUNG considered that the daily conversion limit of RMB20,000 per person for Hong Kong residents might hinder cross-boundary stock trading.

12. CE/HKMA said that S-HK SC was an important milestone in the further opening up of the Mainland's capital markets. When either of the exchanges received orders from their respective clients to trade eligible shares under this new scheme, it would route them onto the trading platforms of the other exchange for execution. The transaction would be settled in the currency of the respective originating market. As the new regime would provide an additional channel for two-way RMB fund flows between the onshore and offshore markets, it was expected to enhance the liquidity of the offshore RMB market and create momentum for further development of the Hong Kong capital markets. CE/HKMA believed that in preparing for implementation of

S-HK SC, it would be an opportune time for the relevant authorities to review the RMB daily conversion limit for Hong Kong residents. In reply to Mr Christopher CHEUNG, CE/HKMA said that investors might hedge against foreign exchange risks on RMB through RMB spot rate/NDF trading. He observed that such transactions experienced rapid growth in recent years.

Banking supervision

13. Mr Jeffrey LAM expressed concern about the difficult business environment faced by locally incorporated banks in Hong Kong, in particular increasingly fierce competition from branches of overseas incorporated banks. He considered that the regulatory regime should take into account the relatively smaller capital size and scale of operation of local banks, and HKMA should devise suitable measures to support the development of local banks.

14. CE/HKMA stressed that all licensed banks in Hong Kong were subject to the same regulatory standards and requirements irrespective of their size while the approach of supervision could be suitably adjusted having regard to the source of the banks' capital. CE/HKMA pointed out that as the public might perceive large financial institutions as more reliable since the Government would likely rescue such institutions from collapsing to avoid systemic risks posed to the banking sector, this might inhibit a level playing field between large and small-sized banks. He believed that the prospective reform to establish an effective resolution regime for financial institutions (including small and medium-sized financial institutions) in Hong Kong would help address the issue and enhance public confidence in small and large financial institutions alike.

15. Mr WONG Kwok-hing welcomed HKMA's initiative to take forward the Treat Customers Fairly Charter ("TCF Charter"). He noted that banks joining the TCF Charter which previously charged dormant account fees had abolished such fees, and those that charged low-balance fees had waived the fees for vulnerable customers and agreed to adopt a flexible approach in relation to the charging of low-balance fees for low-income customers. Mr WONG urged HKMA to follow up and monitor banks' implementation of the measures, in particular to check against whether banks would adopt unfair measures to treat low-income customers.

16. CE/HKMA said that the TCF Charter represented a solemn pledge by all 22 participating retail banks in Hong Kong of their commitment to treating customers fairly. HKMA attached great importance to this joint initiative with the banking industry. As the TCF Charter only set out the high level

principles, it would take further discussion and long-term efforts from banks and HKMA as to how the principles should be put into practice in the provision of banking services.

17. Mr WONG Kwok-hing observed that closure/reduction of bank branches had caused great inconvenience to members of the public, in particular those living in new towns and the less privileged groups. He considered that HKMA should pay attention to the situation and address public concerns on the subject.

18. DCE(B)/HKMA said that, while the opening or closure of branches was essentially a business decision of individual banks, HKMA reckoned the need to strike a balance between commercial considerations and ensuring public access to basic banking services. HKMA had been monitoring the number and coverage of bank branches, and would discuss with banks concerned on alternative modes to provide banking services, such as providing automatic teller machines ("ATMs") and enabling cash withdrawals at selected chain retailers. At the request of Mr WONG Kwok-hing, DCE(B)/HKMA agreed to provide information on the distribution of bank branches and ATMs in Hong Kong.

(Post-meeting note: HKMA's written response was circulated to members vide LC Paper No. CB(1)1547/13-14(02) on 3 June 2014.)

Exchange Fund

19. Mr Andrew LEUNG noted that EF's investment performance in the first quarter of 2014 was poorer than that of the same period in the past two years. He sought HKMA's assessment of EF's investment performance in 2014. CE/HKMA said that it would be difficult to predict the yearly return due to uncertainties in the pace of US interest rate normalization.

20. The Chairman noted that EF's investment income from Hong Kong equities recorded a loss of \$6.8 billion (excluding valuation changes in EF's Strategic Portfolio) in the first quarter of 2014. She sought the reasons for the unsatisfactory performance and asked whether there would be improvement in the investment return following the establishment of mutual access between the Hong Kong and Shanghai stock markets.

21. Atg DCE(M)/HKMA said that 2014 would be a difficult year for EF's investments in view of the possible interest rate hike. For instance, an upward cycle of interest rate would be unfavourable to EF's investment in bonds due to

re-valuation of the fair price of the bonds. Given the uncertainty in the interest rate movement, it was difficult to predict at this stage the return from bonds for 2014. As regards investment return from Hong Kong equities, Atg DCE(M)/HKMA said that it was susceptible to changes in the global and Mainland economic and investment environment. Volatilities of the Hang Seng Index Shares were often triggered by movements of the Mainland A-share index. Based on the current assessment, the outlook on Hong Kong equities remained uncertain. He assured members that HKMA would suitably adjust EF's investment strategy having regard to market developments.

22. Mr TANG Ka-piu noted that the investment performance of government/public funds not placed with EF for investment was not satisfactory, and in most cases their returns were lower than that of EF. He enquired whether the Administration and HKMA would explore the feasibility of placing the government/public funds with EF for making investment, with a view to achieving higher investment return at lower administrative costs for the funds.

23. CE/HKMA said that, under the fee arrangement with the Government, the return on fiscal reserves placed with EF was calculated based on the average annual rate of return of EF's Investment Portfolio over the past six years. It might not be cost-effective or convenient to place certain government/public funds with EF if the fund size was small or the tenor of placement was below six years. In particular, funds involving frequent withdrawal for operational or contingency needs would not be suitable for long-term placement with EF. For funds operated by independent governing boards, their boards might prefer to manage the investment themselves in order to cater for their own needs. Atg DCE(M)/HKMA said that HKMA welcomed suggestions raised by the Government from time to time for placing funds with EF for investment, and would consider each case on its own merits.

Lending business and credit growth

24. Mr Andrew LEUNG sought details about the guidelines and measures adopted by HKMA in the management of credit and liquidity risks on banks arising from credit expansion, in particular loans backed by short-term interbank borrowings.

25. CE/HKMA pointed out that at times of liquidity shortage, as in the period following the global financial crisis in 2008, banks would encounter difficulty in securing interbank loans and might resort to other measures to enhance their liquidity, such as recalling loans from clients or reducing clients'

overdraft limits. However, such measures would have severe impact on the financial position of the corporations concerned. DCE(B)/HKMA said that HKMA had introduced the Stable Funding Requirement in October 2013 requiring banks to maintain longer-term stable fund (e.g. customer deposits and long-term wholesale funding) to support their lending business if their loan growth exceeded a certain threshold. The measure aimed to reduce possible adverse impact on the banking system and credit market arising from future financial market instability.

26. Referring to pages 10 to 13 of the powerpoint presentation, the Chairman enquired about the definition of "Mainland-related lending" adopted by HKMA for conducting risk assessment. DCE(B)/HKMA explained that a "Mainland-related loan" was a loan of which the borrower was a Mainland entity or connected with the Mainland, or if the loan was used in the Mainland. There were three major components of Mainland-related lending, i.e. loans to Mainland enterprises for use in Mainland, loans to Mainland enterprises for use outside the Mainland, and loans to Hong Kong/overseas enterprises for use in the Mainland. This definition was wider than one based purely on location of loan use. As regards the Chairman's enquiry about the ratio of Mainland-related lending to total bank loans, DCE(B)/HKMA said that outstanding Mainland-related loans currently amounted to \$2,588.7 billion (including some \$300 billion in trade finance) accounting for about one-third of around \$6,800 billion of total bank loans.

27. The Chairman expressed concern about the increasing risks posed by shadow banking activities in the Mainland and growth in Mainland-related lending on Hong Kong's financial stability, and enquired whether HKMA would require banks to adopt additional risk management measures in this regard.

28. Mr Albert HO was concerned that as the Mainland authorities were stepping up efforts to combat corruption and market misconduct, strengthened enforcement actions against Mainland enterprises which had obtained loans from Hong Kong-licensed banks might have negative impact on the enterprises' loan-repayment ability and lead to seizure of the collateral pledged by these enterprises. Mr HO considered that HKMA should impose additional requirements on banks with a large exposure to Mainland-related lending for mitigating possible risks arising from the lending business.

29. CE/HKMA commented that as banks played an important role in financial intermediation and given the increasingly closer business and investment ties between the Mainland and other economies, it was a natural

development that Mainland-related lending grew at a faster pace than other loan types. While there were risks associated with Mainland-related lending, it had also given rise to business opportunities in the local financial market. DCE(B)/HKMA further said that the standards for credit risk management to be adopted by banks were basically the same regardless of whether the loans were Mainland-related. However, in view of the growth in Mainland-related lending in recent years, HKMA had stepped up supervision of activities in this area since 2011, including strengthening oversight of subsidiaries of Hong Kong-licensed banks in the Mainland, and reminding banks to manage the associated risks prudently. DCE(B)/HKMA added that since 2011, HKMA had conducted on-site examinations of banks' lending policies and risk management systems on an annual basis. As some of the loans were approved by Mainland subsidiaries of Hong Kong-licensed banks, HKMA had also stepped up the frequency of on-site examinations of these subsidiaries. As regards Mr Albert HO's concern about cross-boundary enforcement cooperation, CE/HKMA said that HKMA maintained close communication and held regular meetings to strengthen collaboration with the Mainland's financial regulators, including in particular the China Banking Regulatory Commission.

30. Mr SIN Chung-kai enquired about the types of collateral involved in Mainland-related lending and the default situation for such loans. CE/HKMA said that collaterals included properties, securities, bank deposits or guarantees issued by the parent companies of the Mainland enterprises. Banks were required to carefully assess borrowers' repayment ability and put in place prudent risk management measures. DCE(B)/HKMA supplemented that all along, banks were reminded to avoid over-reliance on borrowers' collaterals as the first line of defence in lending. HKMA also monitored the quality of Mainland-related loans with reference to the indicator of "classified loans" (i.e. loans that were sub-standard, doubtful or involved loss). He pointed out that the amount of classified loans accounted for about 0.29% of Mainland-related loans, which was lower than the rate of 0.46% for classified loans in total bank loans.

31. Mr James TIEN conveyed concerns from the business sector that the lending policies of banks and lending interest rates in recent years had become more dependent on the liquidity of and loan demand from Mainland banks than the prevailing economic situations. CE/HKMA said that, due to the extensive presence of Mainland banks in Hong Kong, loan demand from these banks could have substantial impact on the credit market. However, Mainland-related loans were usually denominated in USD which should have limited impact on the HKD lending interest rate.

32. Mr Albert HO enquired whether banks would re-assess the credit of Mainland enterprises listed in Hong Kong or demand immediate loan repayment from them if their stocks were suspended from trading due to ongoing investigations by the Mainland authorities. He considered that banks should be vigilant of whether State-owned enterprises or their subsidiaries were genuinely backed by State funding before granting the loans.

33. CE/HKMA said that suspension of trading of a listed entity's shares would not normally affect the day-to-day operation of the entity, including its loan arrangements and cashflow. As there could be different reasons leading to suspension of trading, such as prior to announcements of merger and acquisition, suspension of trading per se would not constitute a credit event that would trigger calling of loans. CE/HKMA said that before arranging a loan to a Mainland enterprise, banks were required to conduct prudent credit assessment of the enterprise concerned, including ascertaining its relationship with the parent company or the relevant Mainland authorities by examining the legal documentation concerned.

Property market and mortgage loans

34. Mr SIN Chung-kai noted that overall flat prices in Hong Kong had edged down and continued to consolidate in recent months. He enquired whether the Government would consider withdrawing the demand-side management measures for addressing the overheated property market in a progressive manner. CE/HKMA said that HKMA had introduced six rounds of countercyclical macroprudential measures since October 2009 to enhance risk management against rise in interest rates and the possible adverse effects on the property market. Notwithstanding the recent market consolidation, a reversal of the property market cycle remained to be seen. HKMA would continue to monitor the situation closely and adjust the macroprudential measures when appropriate.

35. Mr CHAN Kam-lam noted that the outstanding residential mortgage loans increased by about \$80 billion in 2013 and \$30 billion in March 2014. He enquired about the aggregate amount of outstanding residential mortgage loans and its share in total bank loans. He was concerned that adjustment in property market prices might result in an increase in mortgages in negative equity. CE/HKMA said that outstanding residential mortgage loans had reached about \$900 billion at present which accounted for a substantial portion of the some \$6,800 billion total outstanding bank loans. He stressed that residential mortgage was one of the major focuses of banking supervision.

36. Mr James TIEN said that he was involved in real estate business. He enquired whether HKMA had imposed any ceiling on residential mortgage loans (e.g. 70%) to the total loans granted by a bank, and whether it would urge banks to develop mortgage lending policies to complement Government's initiative to assist the young generation to purchase homes at affordable prices. CE/HKMA clarified that no limit was set on banks in respect of the residential mortgage loans and other types of loans. Compared to residential properties of higher value, banks had greater flexibility in mortgage underwriting for residential properties of lower value. The maximum loan-to-value ratio for residential properties with a value below \$6 million was 70% at present, which could be increased to 90% through the mortgage insurance programme subject to relevant requirements.

37. Mr TANG Ka-piu noted that although the growth in property mortgage finance had moderated, the level of household indebtedness as a percentage of Gross Domestic Product had increased to 62.3% in 2013 and total loan growth remained on a rising trend. He enquired about measures that HKMA would consider putting in place when the level of household indebtedness had reached a certain threshold so as to minimize possible negative impact arising from interest rate reversal and asset price adjustment. DCE(B)/HKMA observed that the level of household indebtedness tended to surge during economic downturn. In January 2014, HKMA had requested banks to review and assess their existing policies and risk management systems for underwriting personal loans, having regard to the uncertain interest rate environment and risks on borrowers and banks. HKMA was studying the review data submitted by banks. In reply to Mr TANG, DCE(B)/HKMA said that the review was part of HKMA's supervisory work on which HKMA was obliged to maintain confidentiality. That said, HKMA would issue circulars and guidelines with regard to risk management practices of lending business. The circulars and guidelines were published on HKMA's website from time to time.

38. Mrs Regina IP expressed concern that only some 589 applications were received by end March 2014 for the Reverse Mortgage Programme ("RMP") which was aimed to encourage banks to offer reverse mortgage to persons aged 55 or above. She enquired about the amount of loans approved under the programme. CE/HKMA said that RMP was a relatively new programme providing borrowers the choice to use their self-occupied residential properties in Hong Kong as security to borrow from a participating bank. The amount of loans approved could be in the form of a lump-sum or monthly payouts for improving the borrowers' livelihood or other purposes. In

general, borrowers could continue to stay at the properties for the rest of their life and would not be required to repay their reverse mortgage loan during their lifetime. In light of overseas experience in similar programmes, it would take five to 10 years to raise the awareness and usage of RMP after launch.

SME Financing Guarantee Scheme and Microfinance Scheme

39. Mrs Regina IP noted that 8 531 applications were approved under the SME Financing Guarantee Scheme ("SFGS") operated by the Hong Kong Mortgage Corporation Limited ("HKMC"), involving a total loan amount of \$35.8 billion as at end March 2014. Whereas the Microfinance Scheme received only some 238 applications and the tentative aggregate loan amount was just \$100 million. Mrs IP sought clarification whether HKMC only provided guarantee coverage to enterprises in respect of SFGS loans or the scheme would involve loans offered by HKMC. She also relayed the comments from some members of the public about the high guarantee fee charged by SFGS.

40. CE/HKMA replied that HKMC only acted as an operator of SFGS to provide guarantee coverage on behalf of the Government to help small and medium-sized enterprises and non-listed enterprises to obtain loans from participating lenders. The loans guarantee commitment required approval by the Legislative Council ("LegCo") and both the guaranteed amount and guarantee fees were reflected in government accounts. CE/HKMA said that the SFGS guarantee fee was relatively low with heavy subsidies from the Government.

41. As regards the Microfinance Scheme, CE/HKMA advised that it was a pilot scheme launched in collaboration with banks and non-governmental organizations to offer loans for micro business start-up, self-employment and self-enhancement through training, upgrading of skills or obtaining professional qualifications. As the scheme was on a trial period of three years, the size of tentative aggregate loan at \$100 million was considered appropriate. The loans would be approved having regard to applicants' repayment ability. At the request of Mrs Regina IP, CE/HKMA agreed to provide information on (a) success rate of applications; (b) number of defaults and amounts involved, if any; and (c) assessment of the cost-effectiveness of the said schemes, including the economic benefits brought to Hong Kong, in respect of SFGS and the Microfinance Scheme.

(Post-meeting note: HKMA's written response was circulated to members vide LC Paper No. CB(1)1547/13-14(02) on 3 June 2014.)

Government Bond Programme and development of Islamic finance

42. Mr CHAN Kam-lam noted that the Islamic bonds to be issued under the Government Bond Programme ("GBP") would be likely the world's first Islamic bond ("sukuk") issued by a government with an AAA rating. The underlying assets of the Islamic bonds would be government-owned properties in commercial premises. He considered that the Administration should specify in the product documentation the ownership and usage of the properties in question as this would be useful information for investors.

43. CE/HKMA advised that due to prohibition on receipt and payment of interests under the Islamic law ("Shariah"), a purely debt-based instrument for sale to investors was not permissible under Shariah. Sukuk was asset-based instrument which conformed with the Shariah principles while generated economic effects in a similar way as conventional bonds. The underlying assets of sukuk to be issued under GBP were commercial properties owned by the Hong Kong Special Administrative Region Government. DCE(D)/HKMA said that the details of the underlying assets would be stated clearly in the issuance documents.

44. Mr CHAN Kam-lam observed that the Government's efforts to develop Islamic finance in Hong Kong had not received encouraging response from investors. He enquired about the situation of sukuk issuances in Hong Kong. DCE(D)/HKMA said that six sukuk totalling about US\$5.8 billion had been listed on the Stock Exchange of Hong Kong, two of which were denominated in RMB. He observed that there was keen demand for Islamic financial products in the market, and about 20% to 50% of sukuk investors were local investors. It was envisaged that issuance of sukuk by the Government would signal to the markets that Hong Kong's legal, regulatory and taxation frameworks were well established to facilitate sukuk issuances, thereby giving further impetus to other potential sukuk issuers from the public or private sector to raise funds in Hong Kong. The Administration and HKMA had been working with relevant parties to promote market awareness through road shows and other publicity programmes.

45. Mr TANG Ka-piu noted that only some 10% to 15% of investors in inflation-linked retail bond ("iBond") were first-time investors and iBond did not appeal much to experienced investors as the investment return was relatively low. To increase the liquidity of and broaden investor base for iBond, Mr TANG considered that HKMA should consider issuing iBond specifically for MPF investment. DCE(D)/HKMA said that issuance of iBond

was a non-recurrent measure that was intended to help the public to mitigate inflation pressure and to promote the retail bond market. He observed that the previous iBond issuances did attract first-time bond investors. DCE(D)/HKMA further said that he would relay Mr TANG's suggestion to the relevant authority for consideration.

V Mandatory Provident Fund Schemes (Amendment) Bill 2014

(LC Paper No. CB(1)1309/13-14(04) — Administration's paper on "Mandatory Provident Fund Schemes (Amendment) Bill 2014"

LC Paper No. CB(1)1309/13-14(05) — Background brief on the Mandatory Provident Fund Schemes (Amendment) Bill 2014 prepared by the Legislative Council Secretariat)

Briefing by the Administration

46. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services)² ("DS(FS)²") briefed members on the key legislative proposals under the Mandatory Provident Schemes (Amendment) Bill 2014 ("the Bill") which included allowing more flexibility for Mandatory Provident Fund ("MPF") scheme members in withdrawing accrued benefits, providing a clearer legal basis for the Mandatory Provident Fund Schemes Authority ("MPFA") to approve constituent funds, facilitating trustees' compliance with statutory obligations for more room to reduce MPF fees, updating disclosure arrangements, extending the prosecution time bar and introducing other technical amendments. He said that the proposals would involve legislative amendments to the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") and relevant subsidiary legislation thereunder and the Occupational Retirement Schemes Ordinance (Cap. 426) ("ORSO"), and consequential amendments to the Inland Revenue Ordinance (Cap. 112). The Administration aimed to finalize the Bill for introduction into LegCo by July 2014.

47. With the aid of a powerpoint presentation, the Chief Regulation and

Policy Officer and Executive Director, MPFA ("CRO/MPFA") briefed members on the details of the legislative proposals.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)1375/13-14(02)) were issued to members vide Lotus Notes e-mail on 5 May 2014.)

Discussion

Terminal illness as an additional ground for early withdrawal of MPF benefits

48. Mr WONG Ting-kwong said that he was the Chairman of the MPF Schemes Advisory Committee. He observed that public responses to the legislative proposals were positive in general. Mr WONG enquired about the rationale for adopting "remaining life expectancy of 12 months" as the criterion for permitting early withdrawal of MPF benefits on ground of "terminal illness".

49. CRO/MPFA said that there were different views concerning the appropriate time period of "remaining life expectancy" (e.g. six months, 12 months and other periods exceeding 12 months) for the meaning of "terminal illness". Generally speaking, the medical profession supported using a shorter period such that the medical assessment could be made with greater precision and certainty. The recommended 12-month period was considered most practicable and reasonable, and the same yardstick was adopted for similar purposes in the Australian Superannuation System. As regards Mr WONG Ting-kwong's view that "terminal illness" seemed to imply cancerous diseases only, CRO/MPFA advised that the 12-month life expectancy yardstick, instead of the type of illness, would be the criterion for justifying early withdrawal of MPF benefits on ground of terminal illness.

50. Mr TANG Ka-piu pointed out that there had been known cases in which registered medical practitioners or Chinese medicine practitioners were unwilling to certify the claim for early withdrawal of MPF benefits on the ground of total incapacity due to concerns about legal liability on the practitioners. He expressed concern that scheme members with terminal illnesses might encounter more difficulty in obtaining medical certificates stating that their remaining life expectancy was 12 months or less as this would involve more precise medical estimation. Mr TANG suggested that the Administration should communicate with the relevant medical councils to address such concerns. The Chairman shared similar concern. Mr CHAN

Kin-por said that there was concern about whether registered Chinese medicine practitioners could make the certification objectively and their willingness to make the assessment.

51. DS(FS)2 said that the requirement for obtaining medical certification in respect of remaining life expectancy by a prescribed number of months was not new to Hong Kong and had been adopted in other legislative contexts. The current proposal of 12-month life expectancy for terminal illness had taken into account the views expressed by medical practitioners and Chinese medicine practitioners during previous public consultation, which were supportive of the proposal. In reply to Mr WONG Ting-kwong's enquiry, DS(FS)2 added that medical professionals would not be liable if the scheme member survived longer than the condition certified.

52. The Chairman considered that the 12-month or less life expectancy requirement for justifying early withdrawal of MPF accrued benefits was too harsh, and might put a psychological burden on the scheme member. She considered that it would be sufficiently stringent to require medical proof that the scheme member was suffering from terminal illness or a certain late stage of terminal illness, without specifying the remaining life expectancy. Mr WONG Ting-kwong enquired about the wording required in the medical certificate under the proposal. CRO/MPFA said that it would be sufficient if the medical certificate merely stated that the person had a qualifying condition meeting the requirements in the relevant section of MPFSO.

53. Mr WONG Kwok-hing welcomed the legislative proposals to provide scheme members with more flexibility in withdrawing their accrued benefits. He pointed out that scheme members in need of surgery or other treatment for critical illnesses might wish to receive surgery/treatment at private hospitals instead of public hospitals due to the shorter waiting time. He considered that early withdrawal of MPF accrued benefits should be allowed under such circumstances for scheme members to meet their medical expenses.

54. CRO/MPFA stressed that savings in the MPF system was segregated for retirement purpose only and not intended for meeting other financial needs, such as medical expenses. In determining whether scheme members should be allowed early withdrawal of accrued benefits on a specific ground, eligibility should be based on objective criteria as far as possible to ensure fair treatment. Moreover, providing more flexibility in early withdrawal of accrued benefits should be weighed against the risk that members might withdraw too much too

early and deplete their MPF benefits before retirement. Unlike terminal illness, a critical illness was not necessarily one that was fatal and those scheme members who recovered after treatment would still require retirement protection. It was therefore not recommended to include critical illness as an additional ground for early withdrawal of accrued benefits at this stage.

55. DS(FS)2 said that the Administration and MPFA had considered other suggestions on additional grounds for early withdrawal of MPF accrued benefits (e.g. withdrawing MPF accrued benefits for home purchases). While the Administration/MPFA was sympathetic to scheme members facing certain situations and financial needs, it should be borne in mind that the MPF system was essentially meant for retirement protection.

56. Mr Albert HO considered it inhuman and unreasonable if greater priority should be accorded to retirement protection over financial needs for meeting medical expenses, especially on medical examination, treatment or surgery which would be essential to early diagnosis and healing of critical/terminal illnesses. He pointed out that the issue of remaining life expectancy was hinged on timely diagnosis and treatment. If scheme members were unable to meet impending medical expenses, they might risk losing their life or a shortened remaining life expectancy. In such circumstances, saving up more MPF benefits for retirement would no longer be meaningful to these scheme members. Mr HO indicated that he would consider moving amendments to the Bill with a view to allowing early withdrawal of MPF benefits on ground of meeting expenses on medical treatment which would be critical for saving the life or extending the life expectancy of scheme members.

57. DS(FS)2 said that the grounds for early withdrawal of benefits should be considered in a holistic manner. With the MPF system introduced to help scheme members save for their retirement and the relatively low level of mandatory contributions at 5% only, it would be inconsistent with the policy objective to use the accrued benefits for meeting different needs of a scheme member.

58. At the request of the Chairman, DS(FS)2 agreed to provide written responses to the suggestions raised by Panel members to relax the requirement on "the remaining life expectancy of 12 months" in respect of terminal illness, and to allow early withdrawal of MPF accrued benefits by scheme members for meeting expenses essential to enable early diagnosis and healing of terminal illness.

(Post-meeting note: The Administration's response was circulated to

members vide LC Paper No. CB(1)1556/13-14(01) on 4 June 2014.)

59. Mr SIN Chung-kai enquired whether "total incapacity" as a ground for early withdrawal of MPF accrued benefits included persons in a persistent vegetative state or paralyzed by stroke. CRO/MPFA explained that "total incapacity" was defined in relation to the kind of work that the scheme member was last performing before becoming totally incapacitated. The application of "total incapacity" and "terminal illness" might overlap or supplement each other. For instance, a scheme member could no longer perform the work that he had been performing before a terminal illness and early withdrawal would be allowed under the existing ground of total incapacity. On the other hand, a scheme member in terminal illness might still be able to perform his work and would be allowed to withdraw his MPF accrued benefits early upon certification that his remaining life expectancy was 12 months or less. CRO/MPFA said that there was a view among the medical profession that compared to "total incapacity", it should be technically easier to make assessment and issue certification in relation to "terminal illness" as the assessment would not require consideration of the factor concerning the patient's ability to perform work.

Allowing scheme members to withdraw MPF accrued benefits by installments upon retirement and early retirement

60. Mr CHAN Kin-por opined that the proposal to allow scheme members to withdraw MPF accrued benefits by installments upon retirement and early retirement would provide more choices on withdrawal arrangements for scheme members, and enable them to better plan the use of retirement funds. Mr WONG Ting-kwong enquired whether accrued benefits not yet withdrawn from MPF schemes could continue to be invested in constituent funds chosen by the scheme members. CRO/MPFA replied in the affirmative and stressed that the proposal would not reduce the existing flexibility for scheme members to choose the constituent funds for investing purpose. In reply to Mr WONG, CRO/MPFA supplemented that MPFA would exercise oversight and control on the minimum requirement for phased withdrawal of MPF accrued benefits. The Bill would include provisions on imposing penalties for non-compliance with the minimum requirement for phased withdrawal arrangements.

61. The Chairman noted that trustees would be required to accept requests from scheme members to withdraw up to four times a year only and with at least \$5,000 in each installment free of charge. She suggested that the Administration/MPFA should consider increasing the number of free withdrawals to, say, once per month (i.e. 12 times a year). This would

facilitate elderly scheme members who might wish to withdraw accrued benefits on a monthly basis for meeting their living expenses. She opined that the administration cost so incurred by trustees would not be unduly high. Mr WONG Ting-kwong said that the MPF Schemes Advisory Committee had discussed related issues. The recommended proposal of withdrawal up to four times a year free of charge had taken into account the unique operation of the MPF system which was different from banks.

62. CRO/MPFA and DS(FS)2 said that the current proposal had struck a balance between administration cost and providing flexibility in withdrawal to scheme members. DS(FS)2 said that the Administration/MPFA would discuss with the industry the feasibility of increasing the number of free withdrawals and revert to the Panel on the outcome.

(Post-meeting note: The Administration's written response was circulated to members vide LC Paper No. CB(1)1556/13-14(01) on 4 June 2014.)

63. Mr Albert HO suggested that the Administration/MPFA should consider providing incentives (e.g. a higher percentage of guaranteed return from the MPF investment concerned) to encourage scheme members to opt for phased-withdrawal of accrued benefits, so that scheme members would better plan the use of retirement funds. DS(FS)2 said that issues/suggestions relating to incentives for scheme members to opt for phased-withdrawal were not covered in the public consultation and the current legislative proposals. In considering whether incentives should be provided, due regard must be given to the impact on public finances and the fact that whether to opt for phased withdrawal should be a discretion of scheme members depending on their retirement planning purposes and phased withdrawal was not necessarily the best option to a scheme member. At the request of the Chairman, DS(FS)2 agreed to provide a written response to Mr HO's suggestion.

(Post-meeting note: The Administration's written response was circulated to members vide LC Paper No. CB(1)1556/13-14(01) on 4 June 2014.)

Facilitating trustees' compliance with statutory obligations to provide greater scope for reduction of MPF fees

64. Noting that the Bill would include a number of amendments to provide greater scope for fee reduction by trustees through facilitating the use of electronic means of communication and removing overlapping or unnecessary

certification requirements, Mr SIN Chung-kai enquired about the estimated reduction in the Fund Expense Ratio ("FER") after implementation of the relevant measures.

65. CRO/MPFA said that the relatively high costs of the MPF System were mainly due to the established administrative process, in particular the manual and paper-based administration processing. Hence streamlining and automating the relevant procedures would help achieve reduction in costs and MPF fees in the long run. He mentioned that the actual benefits that could be realized would be affected by a number of factors such as the scale of assets under management (which would limit the benefits of economies of scale), operational efficiency and members' decision making, however an earlier consultant's report had suggested FER reductions in the order of 0.05%. As regards Mr SIN Chung-kai's concern that MPF trustees might pass the costs for relevant system development onto scheme members, CRO/MPFA said that the amendments in question would facilitate communication between trustees and scheme members through electronic means like sending of prescribed documents instead of manual and paper-based methods. The costs for system development should be compensated by the savings and benefits achieved in the longer run.

Approval of new MPF schemes and constituent funds

66. Mr CHAN Kin-por noted that one of the legislative proposals was to provide MPFA with a clear basis to refuse applications for new MPF schemes/funds with a view to further tightening the approval to avoid proliferation of fund choices which would not be conducive to fee reduction. He cautioned that MPFA should not tighten the approval indiscriminately as it would be in scheme members' interests to approve new schemes/funds with low fees and to maintain a sufficient number of funds offering genuine choices for selection by scheme members. CRO/MPFA pointed out that, as the scale of assets of individual MPF scheme/fund under management would impact on the extent of benefits achievable from economies of scale, it was necessary to ensure that only scheme/funds which were beneficial to scheme members (e.g. schemes/funds with reduced fees) would be approved and avoid unnecessary proliferation of fund choices merely for the sake of marketing. In reply to Mr CHAN's enquiry, CRO/MPFA added that the existing appeal mechanism of MPFA would be available for applicants to appeal against MPFA's decisions in refusing applications for new MPF schemes/funds.

Revisions to disclosure arrangements in secrecy provisions

67. Mr TANG Ka-piu noted that one of the legislative proposals was to amend the secrecy provisions of MPFSO and ORSO to allow trustees and administrators to disclose information with the consent of individual scheme members; or to disclose a summary of information without identifying the members concerned. The purpose of the amendments was to facilitate compliance by trustees/administrators with requirements contemplated by some jurisdictions on foreign financial institutions to report to their tax authorities in respect of accounts or taxpayers that might be subject to their tax regimes. Mr TANG enquired whether the legislative amendments would enable the Administration/MPFA to obtain from MPF trustees information on investment return on individual MPF schemes/funds. DS(FS)2 and CRO/MPFA pointed out that the issue raised by Mr TANG (i.e. the percentage of MPF scheme members with investment return above/below the average investment return in the MPF system) concerned data collection in the MPF system which was a different matter. The purpose of the legislative amendments in question was to enable disclosure of data collected in the MPF system to a third party (i.e. a foreign tax authority) and not to enhance MPFA's powers to obtain particular information from MPF trustees or ORSO scheme administrators.

VI Review of abscondee regime under the Bankruptcy Ordinance (Cap. 6)

(LC Paper No. CB(1)1309/13-14(06) — Administration's paper on "Review of the Abscondee Regime under the Bankruptcy Ordinance")

Briefing by the Administration

68. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services)3 ("DS(FS)3") briefed members on the progress of the review of the abscondee regime provided for in section 30A(10) of the Bankruptcy Ordinance (Cap. 6) ("BO") and the two alternative reform approaches proposed by the Administration, viz. the Modified Abscondee Approach and the Interview Approach set out in paragraphs 8 and 10 of the Administration's paper respectively. DS(FS)3 pointed out that the Administration had been engaging with relevant stakeholder groups to discuss the details of the proposals.

Discussion

69. Mr Albert HO considered the proposed Interview Approach more reasonable as it was necessary for the abscondee regime to take into account compliance by a bankrupt with the legal obligations of bankruptcy rather than simply the bankrupt's presence in Hong Kong. Mr HO opined that the specified circumstances to be considered under the Interview Approach, such as the failures of the bankrupt to attend a face-to-face interview and to cooperate with the trustee-in-bankruptcy ("TIB") during the interview, should be set out as clearly as possible in the legislative amendments. He enquired about the timeframe of the legislative exercise on the review of abscondee regime. Mr HO further asked whether the Administration would review other aspects of BO, including implementation issues relating to the discharge of bankrupts which had occasionally led to disputes, and some other implementation issues he had suggested.

70. DS(FS)3 responded that as opposed to the Modified Abscondee Approach, under which an application would be considered having regard to physical presence of the bankrupt in Hong Kong, the Interview Approach would require consideration of whether the bankrupt had attended the interview and performed certain tasks during the interview, which was considered as very important for bankruptcy administration. From a practical perspective, it might not be possible to set out in very specific terms an exhaustive list of the tasks involved in an interview which would be applicable to all cases. However, the court's discretion in whether to suspend the bankruptcy period would be an appropriate check and balance under this approach.

71. On the engagement with relevant stakeholders and the timeframe of the legislative exercise, DS(FS)3 advised that the Administration would engage relevant stakeholder groups, including creditor groups, private insolvency practitioners, professional bodies and other relevant organizations, to gauge their views on the reform approaches in the coming months. Noting that the Panel's preliminary preference for the Interview Approach, subject to stakeholders' views, the Administration would develop detailed legislative proposals on that basis. It was the Administration's target to introduce the relevant bill into LegCo in 2015 and complete the legislative exercise within the current legislative term.

72. As regards the scope of the legislative exercise, DS(FS)3 said that the exercise aimed to address the constitutional issue with respect to the existing section 30A(10) of BO arising from an earlier court ruling. This was not an overall review of BO which would be much more complicated and would take much more time to complete. From a practical perspective, it would not be possible to expand the scope of the current exercise to cover other aspects of BO given the aim to complete the legislative exercise in the current LegCo term, especially in view of the need to go through the due process of consultations and stakeholders' engagement on such other proposals for legislative amendments.

73. Mr WONG Ting-kwong pointed out that bankruptcy orders were made by courts and it was justified to require a bankrupt to comply with the relevant legal obligations, including meeting with the TIB for bankruptcy administration. He enquired why certain requirements under section 30A(10) of BO were ruled unconstitutional and whether the Administration had appealed to the Court of Final Appeal on the court case concerned.

74. DS(FS)3 clarified that under Hong Kong's bankruptcy regime, while a bankruptcy order was made by the court, the obligations of a bankrupt were set out in BO. In the court case concerned, the Court of Final Appeal had ruled that section 30A(10)(b)(i) of BO was unconstitutional after detailed consideration of the appeal.

75. In response to the Chairman's enquiry on the timeframe of engagement with relevant stakeholders on the two alternative reform proposals, DS(FS)3 said that in light of the Panel's support in-principle for the Interview Approach, the Administration would, subject to the feedback of stakeholders in the next few months, develop detailed legislative proposals based on the approach and prepare the relevant Bill with a view to introducing it into LegCo in 2015.

VII Annual briefing on the work of the Financial Reporting Council

(LC Paper No. CB(1)1309/13-14(07) — Paper on "Progress Report on the work of the Financial Reporting Council" provided by the Financial Reporting Council

LC Paper No. CB(1)1309/13-14(08) — Background brief on the

work of the Financial
Reporting Council
prepared by the Legislative
Council Secretariat)

Briefing by the Administration

76. At the invitation of the Chairman, the Chairman, Financial Reporting Council ("Chairman/FRC") briefed members on the background, organization, membership and functions of FRC. The Chief Executive Officer, FRC ("CEO/FRC") and the Deputy Chief Executive Officer, FRC then briefed members, through a powerpoint presentation, on the work of FRC in the past year.

(*Post-meeting note:* The notes of the powerpoint presentation (LC Paper No. CB(1)1375/13-14(03)) were issued to members vide Lotus Notes e-mail on 8 May 2014.)

Disclosure

77. Mr SIN Chung-kai said that he was a non-remunerated member of FRC.

Discussion

Governance and financial arrangements for FRC

78. Mr Kenneth LEUNG enquired whether members of the Honorary Advisory Panel ("HAP") and the Process Review Panel ("PRP") of FRC consisted of partners of the Big Four accounting firms; and if so, what measures FRC had put in place to avoid possible conflict of interests; and if not so, how FRC could ensure the two panels had adequate professional knowledge and expertise in discharging their duties in an effective manner.

79. Chairman/FRC responded that members of HAP and PRP consisted of both partners of the Big Four accounting firms and lay persons. He said that HAP served as an advisory body on the work of FRC. It currently consisted of 12 members including lay persons and retired accountants and auditors. CEO/FRC supplemented that anyone assisting in the work of FRC would be subject to stringent requirements on declaration of interest and would not be involved in discussion of any cases in which he/she had an interest. While experts/partners of the Big Four or small and medium-sized accounting firms

would be involved in the work of HAP and PRP, most members of the two panels were lay persons.

80. Noting that FRC had a budget deficit in 2013, Mr Kenneth LEUNG expressed concern about the stability of FRC's financial position in the long run. He enquired whether the Administration/FRC would review FRC's existing funding arrangements, and whether a new funding arrangement with listed companies contributing to the operating costs of FRC would be considered.

81. Chairman/FRC responded that the existing funding arrangement agreed among the Government, HKEx, the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the Securities and Futures Commission ("SFC") would end in 2014 and FRC was discussing with the four funding parties on the future funding agreement. He added that FRC had a reserve of around \$30 million and the amount was sufficient to support FRC's operation in the short run unless there was a dramatic increase in FRC's workload.

Progress of the auditor regulatory reform

82. Referring to the recent internal consultation conducted by HKICPA on the proposals for the auditor regulatory reform in Hong Kong, Mr Kenneth LEUNG enquired why FRC had not responded to the issues raised by HKICPA, and the timetable of the reform.

83. Chairman/FRC responded that FRC had been assisting the Government in its efforts to develop the auditor regulatory reform. FRC was aware of the Government's plan to launch a public consultation on the reform proposals in 2014 and would closely monitor the progress of the reform and participate in the relevant consultation. FRC's Independent Audit Oversight Reform Committee would advise the Council in preparation of FRC's response to the consultation paper. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)⁴ ("PAS(FS)4") confirmed that it was the Administration's target to conduct the public consultation exercise in 2014.

84. The Chairman pointed out that during HKICPA's internal consultation on the auditor regulatory reform, stakeholders including large and small and medium-sized accounting firms had expressed different views on a number of issues. She stressed the need for the Administration to gauge the views of different stakeholders, and urged the Administration to make reference to the legislative exercise of establishing the independent Insurance Authority to

establish a representative consultative committee so that the views of all stakeholders (and not just those of HKICPA) would be taken into account and fully considered.

85. PAS(FS)4 said that preparation for the auditor regulatory reform had commenced for sometime and the Administration had been maintaining close contact with FRC and HKICPA in working out the reform proposals. There was a general consensus among stakeholders to take forward the reform. He assured members that the Administration would continue to liaise with and gauge the views of various stakeholders, including regulators, the auditing industry and listed companies in the consultation process.

Investigation and enquiry work of FRC

86. On the investigations or enquiries initiated by FRC upon receipt of complaints referred from regulators and organizations like HKMA, SFC and HKEx, Mr CHAN Kam-lam enquired about the proportion of substantiated cases among the referred complaints (including the 13 complaints referred by HKEx in 2013), and whether all the substantiated cases would be referred to HKICPA for follow-up.

87. CEO/FRC said that most of the complaints received by FRC were from regulators and relevant organizations such as HKEx. Upon receipt of a complaint, relevant staff of FRC would assess the complaint and prepare a complaint assessment report, which would then be considered by the Operations Oversight Committee and the Council of FRC. FRC would initiate investigations or enquiries into pursuable cases. Since its inception, FRC had referred 21 cases to HKICPA for consideration of disciplinary actions. In most of the cases referred to HKICPA, FRC had identified auditing or reporting irregularities. Regarding the 13 complaints referred by HKEx, CEO/FRC pointed out that FRC had completed the review of six cases and commenced four investigations on the basis of the review. FRC would process the remaining six cases in 2014.

88. In response to Mr CHAN Kam-lam's enquiry about whether FRC would initiate investigations or enquiries into complaints that were found to be trivial, and whether it would inform the complainants concerned about the outcome of the review, CEO/FRC said that upon receipt of a complaint, relevant officers of FRC and the Operations Oversight Committee would examine whether it was pursuable. If the complaint was not pursuable, FRC would advise the complainant and the parties concerned. If the complaint was pursuable and investigations were to be conducted, FRC would not alert the

parties concerned until the investigation process had been concluded.

89. As regards Mr Albert HO's enquiry about the difference between investigations and enquiries initiated by FRC, Chairman/FRC remarked that in accordance with the Financial Reporting Council Ordinance (Cap. 588), FRC would initiate investigations into suspected auditing or reporting irregularities identified of accountants and initiate enquiries into possible non-compliance with accounting requirements in relation to listed entities.

90. Pointing out that in end-2012 and end-2013, around half of FRC's investigations in the year concerned were still in progress, Mr Albert HO enquired about the average processing time for FRC in conducting an investigation. He also enquired about the number of substantiated cases referred to HKICPA for follow-up of which HKICPA had taken disciplinary actions, as well as the timeframe required by HKICPA in conducting disciplinary hearings for the cases concerned.

91. CEO/FRC responded that depending on the complexity of a case, an investigation/enquiry of FRC would take around a year or more to complete. FRC would not conduct hearings in conducting investigations and enquiries on cases. It would mainly carry out investigation/enquiry through examining relevant documents. For procedural fairness, draft reports of investigations and enquiries would be sent to the parties concerned for comments. CEO/FRC added that HKICPA had its own internal procedures to handle cases referred by FRC and the process might take a considerable period of time.

92. Mr Albert HO considered that FRC should step up the transparency of the investigation or enquiry process by disclosing relevant information like whether to admit a complaint and the reasons if the complaint was rejected, and notifying the complainants about the results of the investigations or enquiries.

93. CEO/FRC responded that if FRC decided not to pursue a complaint, it would communicate with the complainant concerned and explain the reasons on its decision. Most of the complaints were referred by regulators which were familiar with the complaint handling process of FRC. For cases referred to HKICPA for follow-up, FRC would publish the results of the investigations on a no-name basis. The names of the parties concerned would be released after HKICPA had completed its disciplinary proceedings.

VIII Any other business

94. There being no other business, the meeting ended at 12:30 pm.

Council Business Division 1
Legislative Council Secretariat
25 August 2014